

## PROFESSIONAL INDEMNITY UPDATE

JULY 2009

### Absolute/strict obligations

1. The default position:

*“The law does not usually imply a warranty that [a professional man] will achieve a desired result, but only a term that he will use reasonable care and skill. The surgeon does not warrant that he will cure the patient. Nor does the solicitor warrant that he will win the case.”<sup>1</sup>*

2. Sometimes it is possible for a claimant to move away from the default position, and to treat the professional defendant as having undertaken an absolute or strict obligation – ie one that is defined by reference to:

- a result that the professional ‘warrants’ will be achieved; and not
- the service that is (or is not) provided with reasonable skill and care.

3. The advantages of establishing a strict contractual obligation are:

- (1) There is no need to prove negligence, merely a failure to achieve what was required by the term or warranty.

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<sup>1</sup> *Greaves v Baynham Meikle* [1975] 1 WLR 1095.

- (2) There is no defence of contributory negligence.
  - (3) The measure of damages is the contractual measure (an award placing the claimant in the position in which he would have been if the warranted result had been achieved) – which can work in the claimant’s favour<sup>2</sup>.
4. In the litigation following the property crash in the early 1990s claimant lenders who relied only on failure by defendant solicitors and valuers to exercise reasonable skill and care often found that awards of damages were reduced considerably to take account of their own contributory negligence. This prompted a number of attempts to persuade the courts that the defendants were subject to and in breach of strict contractual obligations.
  5. In *Zwebner v The Mortgage Corp* [1998] PNLR 769 the wife’s signature on the charge document was forged. The solicitor had provided an undertaking that the charge was “properly executed”. He had been taken in by a skilful fraud, and was not culpable. The Court of Appeal held that the fact that negligence was not proved against the solicitor was irrelevant – he had warranted a result and was liable to pay damages that would place the lender in the position in which it would have been if the charge had indeed been properly executed.
  6. However, the tide turned. In later cases the Court of Appeal was resistant to the argument that solicitors were to be taken to have undertaken strict obligations that exposed them to substantial liabilities even in the absence of negligence.
  7. For example, in *Midland Bank Plc v. Cox McQueen* [1999] P.N.L.R. 593 the defendant solicitors were retained by the lending bank to obtain the signatures of the borrowers, Mr and Mrs Duke, on the mortgage deed and explain it to them. Mr Duke introduced an imposter as his wife and the solicitors failed to obtain the signature of Mrs Duke or to give her any advice. The bank alleged that the solicitors had been under a strict contractual obligation. The Court of Appeal disagreed. Lord Woolf MR said:

*“If commercial institutions such as banks wish to impose an absolute liability on members of a profession they should do so in clear terms so that the*

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<sup>2</sup> In such a case it is not open to a defendant to argue “*you could never have achieved the result that I warranted would be achieved*” – that may be so, but it is irrelevant.

*solicitors can appreciate the extent of their obligation which they are accepting... Unless the language used in a retainer clearly has this consequence, the courts should not be ready to impose obligations on solicitors which even the most careful solicitor may not be able to meet.”*

The decisions in *Mercantile Credit Company v. Fenwick* [1999] Lloyd’s Rep. P.N. 408 and *Barclays Bank Plc v Weeks Legg & Dean (a firm)* [1999] Q.B. 309 were to similar effect.

8. The recent decision in *Platform Funding Ltd v. Bank of Scotland Plc* [2008] EWCA Civ 930 re-opens the debate. The claimant was proposing to lend money to a Mr David Hewes to be secured against 1 Bakers Yard, Belchmere Lane, Gosberton, Lincolnshire. That property consisted of a building plot on which a house was being built. The defendant valuers were engaged to value the property. Mr Hewes tricked them into valuing 5 Bakers Yard, a nearby plot on which a house was nearly completed. This was fairly easy to do because the plots were not numbered. The valuers reported back, certifying that they had inspected the property, i.e. 1 Bakers Yard. The claimant did not try to argue that the valuer had been negligent. Cases in which a valuer inspects the wrong property must be rare, one would have thought, and would normally involve carelessness on an impressive scale. But in this case negligence was not alleged.
9. These somewhat unusual facts produced an unusual result.
10. By a majority (Sir Anthony Clarke M.R. dissenting) the Court of Appeal held that the valuers were under a strict contractual obligation to inspect the right property. Moore-Bick LJ, with whom Rix LJ agreed, gave the leading judgment. He reviewed the earlier authorities and considered the various aspects of the work which the valuers undertook to carry out. He concluded that a valuer who is retained to inspect a certain property is to be taken to have undertaken an absolute obligation to inspect that property.
11. Agreeing, Rix LJ said that “it is not possible to support a blanket approach whereby, even in the absence of an express warranty, a professional’s responsibility is nevertheless always limited to the taking of reasonable care”. He pointed out that, if a valuer who inspected and valued the wrong property were not in breach of contract,

he would be entitled to his fee even though the client had not received what he had contracted for.

12. The lender also relied upon a statement that the valuer “certified” that he had inspected the relevant property. The majority decision appears not to have rested on this point.
13. The decision in *Platform Funding Ltd v. Bank of Scotland Plc* will undoubtedly lead to arguments that various aspects of professional retainers in a wide range of professions constituted strict contractual obligations rather than tasks to which the professional firm undertook to bring the exercise of reasonable skill and care.
14. The earlier cases such as *Cox McQueen* demonstrate an awareness in the Court of Appeal – as constituted in the late 90s – that professional indemnity premiums were getting too high, and that policy reasons demanded that claims based on strict contractual obligations should not be allowed to succeed save where the obligation was imposed by very clear words. *Platform* marks a regression, and time will tell whether the minority judgment of the MR is to be preferred.

### **Duties to third parties**

15. In *Whitehead v. Hibbert Pownall & Newton* [2008] P.N.L.R. 25, a woman, PM, gave birth to a child suffering from spina bifida. PM instructed the defendant firm of solicitors to sue the hospital for failing to diagnose the child’s condition antenatally, alleging that had they done so she would have terminated the pregnancy. Proceedings were issued on 12 January 1989, but by 6 March 1995 the action was still not listed for trial; that day, PM, who had been the child’s main carer, committed suicide. Some years later, the hospital sought to have the claim struck out for want of prosecution. With that application pending, the child’s father, EW, as administrator of PM’s estate, settled the claim on a heavily discounted basis that reflected the risk that the action would be struck out. EW subsequently brought an action against the defendants both on behalf of PM’s estate and in his personal capacity for failing to bring the claim to a conclusion before PM’s death and for under-settling the claim. By his personal claim EW sought damages to compensate him for the cost of the child’s care, which he

claimed to have incurred, and to continue to be incurring, after PM's death, such expenses allegedly being caused by the defendants' failure properly to conduct on his behalf the underlying claim against the health authority.

16. One issue in the case was whether EW was owed a duty of care by the solicitors.
17. The Court of Appeal held: no duty. The interests of the father were not coincident with the interests of the mother, the solicitor's client. It would therefore place the solicitors in an impossible position if they were to owe conflicting duties, one to a client, another to a non-client.
18. The decision of Akenhead J in *Galliford Try Infrastructure Ltd v. Mott Macdonald Ltd* [2009] P.N.L.R. 129 is equally orthodox. In that case the claimant was the main contractor. The defendant was engaged by a sub-sub-contractor to provide structural and building engineering services. It had been intended that the defendant's contract with the sub-sub-contractor would be novated with the claimant, but this was never done. When things went wrong, the claimant sued the defendant in tort. The judge carried out an extensive review of the authorities. He also made a number of crucial findings of fact, not least that the engineers had worked under the direction of the sub-sub-contractors rather than the claimant and that, while they knew that drawings and other information they provided to the sub-sub-contractors would be passed up the contractual chain and relied upon by the claimant, the engineers were doing no more than fulfil their contractual obligations when providing such information. He then concluded, as will usually be the case absent some assumption of direct responsibility or other unusual feature, that no duty of care was owed.
19. In *Realstone Ltd v. J & E Shepherd* [2008] P.N.L.R. 574 an application to strike out a claim based on a duty of care which cut across a contractual chain was dismissed, the court recognising that the question whether a duty of care was owed was too fact sensitive for summary resolution.

#### *Liquidators and investors*

20. In *Hague v. Nam Tai Electronics* [2008] BCC 295 the Privy Council held that a liquidator of a company did not owe a duty of care in tort to individual creditors when dealing with the company's assets.

## Duties of Insurance Brokers

21. The decision of Tomlinson J in *Standard Life Assurance Ltd v. Oak Dedicated Ltd* [2008] Lloyd's Rep. I.R. 522 is partly concerned with the true construction of a policy of professional indemnity insurance. The cover was £75 million with an excess of £25 million "each and every claim and/or claimant". The problem was the words "and/or claimant" which appeared to mean that cover would only be triggered under the policy if an individual claimant had a claim or series of related claims which came to over £25 million. The obvious purpose of the insurance was to provide cover against exposure to a large number of related claims by different people for mis-selling investment products to consumers. That risk had materialised and the insured had paid over £100 million to some 97,000 consumers for mis-selling endowment policies. Insurers took the point that no claimant had received anything like £25 million.
22. Despite the uncommercial effect of insurers' construction, Tomlinson J felt constrained to accept it. This was because the words "and/or claimant" had been deliberately introduced and no one had any plausible explanation of their presence other than a desire to introduce a per claimant deductible of £25 million.
23. The insured claimed against its brokers. Tomlinson J held them liable. In doing so he set out a number of propositions as to the broker's duties:
  - “(1) It is the duty of a broker to identify and advise the client about the type and scope of cover which the client needs and, in doing so, to match as precisely as possible the risk exposures which have been identified within the client's business with the coverage available.
  - (2) Having identified what cover the client needs, it is the broker's duty to arrange insurance cover which clearly meets those requirements.
  - (3) If the cover which is needed by the client is not available, the broker must take care to ensure that the precise nature of what is and is not covered is made entirely clear to the client.
  - (4) In relation to the preparation of the policy, the broker must be careful to ensure that the policy language clearly encompasses the needs of the client.
  - (5) The duties of the broker on the renewal of an existing policy are no different from on the initial placement, and at each renewal the broker must ensure that the cover arranged clearly meets the client's needs in the most appropriate manner.”

24. The need for a broker to obtain a proper understanding of his client's insurance needs was also emphasised in *Ramco Ltd v. Weller Russell & Laws Insurance Brokers Ltd* [2009] Lloyd's Rep. I.R. 27.

### **Claims against Barristers**

25. It is fair to say that barristers fare better in court – as defendants – than insurance brokers.
26. In *Williams v. Thompson Leatherdale and Francis* [2008] 2574 (QB) a senior junior barrister specialising in ancillary relief was sued for failing to advise his client that the then forthcoming decision of the House of Lords in *White v. White* [2001] A.C. 596 might entitle her to more than she would receive under the terms of a settlement. Assessing against the relevant standard of care, which he held to be “that expected of a competent barrister of [the Defendant's] seniority in 2000 who holds himself out as being an expert in ancillary relief”, Field J held that the failure to advise his client that there was a real possibility that the law would change in her favour was not a mere error of judgment, but negligent. However, he went on to find that the claimant had failed to prove any recoverable loss.
27. In *Pritchard Joyce & Hinds (a firm) v. Batcup* [2009] EWCA Civ 369 the Court of Appeal reversed the decision of Underhill J that leading and junior counsel had been negligent for failing to advise their clients as to the time limit applicable to a possible claim against their former solicitors. The potential claim which it was alleged was lost as a result of the barristers' negligence was for failing to advise of the time limit for suing yet another firm of solicitors. The Court of Appeal emphasised the need to avoid hindsight. While it might not be necessary for a negligent error to “leap from the page”, the need to carry out a “minutely detailed reconstruction with the assistance of thousands of documents of events going back over many years before any finding could be made even as to what the error might have been” was, perhaps, “a pointer to the conclusion that if error there was, it was not so blatant as to amount to negligent professional conduct”.

## **Groping in the dark**

28. A further point to arise from the Court of Appeal's decision in *Whitehead*, discussed above in relation to the duty of care issues, is that in 'lost litigation' claims against lawyers (typically due to strike-out for delay etc), events occurring after the notional trial date for the original action can be taken into account, in order to avoid an award of damages being made that at trial can be seen to be either too high or too low. The decision accords with and extends the Court of Appeal's (partly obiter) observations in *Charles v. Hugh James Jones and Jenkins* [2000] 1 W.L.R. 1278; and with that court's decision in *Dudarec v Andrews* [2006] 1 WLR 3002. The dictum in *Bwllfa v. Merthyr Dare Steam Colliery (1891) Ltd* [1903] A.C. 426 that with the light before them, judges should refrain from groping in the dark is much cited in this line of cases.
29. The question which arose in *Whitehead* was whether, in calculating the loss caused by the solicitors' negligence, a process which in turn required an assessment of the losses which would have been awarded in relation to the underlying claim, the court should take account of PM's death, a fact unknown and unknowable as at the notional trial date, which if accounted for would reduce the damages due. If PM's death was disregarded then damages compensating her for acting as the child's carer for a number of years going forward would be due. On the other hand, if her death was taken into account, then the number of years for which such damages were due would be significantly lower.
30. The Court of Appeal held that the full facts known at the time of the trial of the second action should be considered so as to prevent what would otherwise be an unwarranted windfall.

## **Limitation**

31. In *Law Society v. Sephton & Co* [2006] 2 A.C. 543 the House of Lords held that in English law exposure to a mere contingency of a future claim does not constitute actionable damage. They upheld decisions such as *Forster v. Outred Co.* [1982] 1

W.L.R. 86, but on the basis that in each case the claimant had suffered actual loss more than 6 years before proceedings had been begun. In *Law Society v. Sephton* itself the claimant was the Law Society which had a discretion whether to pay claims against its compensation fund by the victims of fraud. The defendant accountants had failed to detect fraud more than 10 years before the issue of proceedings. The defence of limitation failed because the Law Society had not suffered actionable damage when it became exposed to the risk of claims, but only when the claims were paid.

32. In *Watkins v. Jones Maidment Wilson (a firm)* [2008] P.N.L.R. 23 the Court of Appeal held that *Law Society v. Sephton* had not changed the limitation position where a defendant solicitor allegedly drafted an agreement negligently so as to confer lesser rights on his client than he should have done. In such cases actionable damage is suffered when the poorly drafted agreement is entered and the claimant receives less than he is entitled to. The Court of Appeal held that cases such as *D.W. Moore v. Ferrier* [1988] 1 W.L.R. 267 remain good law.
33. More difficult is the decision of the Court of Appeal in *Shore v. Sedgwick Financial Services Ltd* [2008] EWCA Civ 863; [2008] P.N.L.R. 37, a pensions mis-selling case. The defendant negligently advised the claimant about the risks of transferring from his occupational pension scheme into another pension scheme. In reliance on this inadequate advice the claimant transferred more than 6 years before the issue of proceedings. The issue arose as to when actionable damage was suffered: was it on transfer, or when it was clear that the new scheme was conferring less valuable rights than the occupational scheme would have done?
34. Finding against the claimant, Dyson LJ held that his was not a “pure contingent liability case” such as *Law Society v. Sephton*. Rather it was a “transaction” case under which the claimant suffered damage when he transferred. The claimant’s case on liability was that the new scheme was inferior to the occupational pension scheme. It followed that he had suffered loss when he transferred to it, even though he might, in theory, have been better off in the new scheme. The new scheme would have to have performed extraordinarily well to achieve this result and was plainly much more risky than the occupational scheme.
35. Dyson LJ held that in “transaction” cases it was always possible that the risk against which the defendant had failed to secure adequate protection, might not materialise.

For example, on this analysis in *D.W. Moore v. Ferrier* [1988] 1 W.L.R. 267, the risk was that the director would leave the plaintiff's employment and compete with it in circumstances in which the claimant did not have the benefit of an enforceable restrictive covenant. Dyson L.J. said that "it is the possibility of actual financial harm that constitutes the loss". This is not the conventional analysis of the "transaction" cases, which is that the claimant suffers actual loss by receiving less valuable rights than it should have done as a result of the defendant's breach of duty (in *D.W. Moore v. Ferrier* an enforceable restrictive covenant). It is right to say that the reason why the rights are less valuable may be that the claimant is exposed to a risk or contingency against which he should have been protected, but that is not the same as saying that the risk or contingency itself constitutes the loss. *Shore v. Sedgwick Financial Services Ltd* appears to lean towards the wider interpretation of *Forster v. Outred & Co* [1982] 1 W.L.R. 86 which was rejected by the House of Lords in *Law Society v. Sephton*.

36. Two more recent decisions at first instance contain full and helpful discussions of the authorities and principles.
37. The first is the decision of Lewison J in *Pegasus Management Holdings SCA v. Ernst & Young (a firm)* [2008] [2009] P.N.L.R. 11. The facts of the case are complicated. The interest of the case lies not so much in the outcome, as in the judge's fastidious dissection of the mass of appellate authority that has been generated by the apparently mundane question: "*when did the claimant suffer loss*"?
38. As Lewison J drily observed, despite the "judicial firepower" that has been brought on bear on this issue, the task of the first instance judge who is faced with this issue is not an easy one.
39. A second recent first instance decision concerned claims against solicitors who "vetted" potential claims for after the event insurers. Under the terms of the relevant insurance scheme, only claims which stood at least a 51% chance of success and were worth at least £1,000 should have been allowed through the vetting process. Once through, the claimant insurer would provide after the event insurance. The insurer alleged that some 26,000 claims had been negligently vetted and that, as a result, it had lost about £65 million. This was mainly because it had insured claims which did not stand at least a 51% chance of success.

40. About 7,400 cases the insurance policy had been issued more than 6 years before proceedings were issued. Any claim for breach of contract in relation to the vetting process which took place before the insurance was issued was clearly statute barred. But the insurer argued that the concurrent claim in negligence was not statute barred, because actionable damage was only suffered when an insured claim failed and it was called upon to pay under the insurance. That would only happen some time after the policy had been issued. Before then, argued the insurer, it was only subject to a purely contingent liability. The issue of limitation was tried on assumed facts before Flaux J: *Axa Insurance Ltd v. Akhter & Derby Solicitors and Others* [2009] EWHC 635 (Comm).
41. Flaux J found against the insurer. Loss was suffered when the policies were issued. The complaint against the solicitors was that they had, through their negligent vetting, caused the insurer to insure claims which stood less than a 51% chance of success. The insurer should only have insured claims which had at least a 51% chance of success. So, in respect of each negligently vetted claim, the insurer entered a contract which did not have the characteristics which it should have done. The insurer was accepting a greater risk than it wished to or should have done.
42. Both *Pegasus Management Holdings* and *Axa Insurance Ltd* are going to the Court of Appeal later this year.

### *Ex turpi causa*

43. The recent decision in *Stone & Rolls v. Moore Stephens* [2008] EWCA Civ 644; [2008] 3 W.L.R. 1146 is currently being considered by the House of Lords.
44. The liquidators of the claimant company sued its auditors for failing to detect the dishonest behaviour of a Mr Stojevic, who was at all material times the directing mind and will of the company and also its sole shareholder. Mr Stojevic's fraudulent behaviour in respect of various banks had given rise to substantial liabilities to those banks on the part of the company. The defendants applied for the claim to be struck out on the basis that the company incurred the liabilities in question as a result of its own fraud, and that its action was therefore barred by the maxim *ex turpi causa non*

*oritur actio*. The claimant disputed this, on the basis (a) that it had itself been the victim of the fraud, and therefore should not have attributed to it the knowledge of Mr Stojevic; and (b) that *ex turpi causa* could not be relied upon by the defendants when detecting dishonesty was the “very thing” which it had been engaged to do.

45. The Court of Appeal struck the claim out. The company was itself the vehicle of the fraud and therefore was “villain” not “victim”; accordingly it should have attributed to it the knowledge of Mr Stojevic.
46. The decision of the House of Lords should make interesting reading.

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<sup>3</sup> Who has not contributed to the section on limitation.